Supreme Court, U.S.
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No. _____

In The

Supreme Court of the United States

October Term, 1996

THE GREENE COUNTY BANK,

Petitioner,

v.

FEDERAL DEPOSIT INSURANCE CORPORATION,

Respondent.

On Petition For A Writ Of Certiorari To The United States Court Of Appeals For The Eighth Circuit

PETITION FOR A WRIT OF CERTIORARI

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QUESTION PRESENTED

Whether the term "unsafe and unsound," as used in 12 U.S.C. § 1818(b)(1), means that practices and conditions must have a reasonably direct and adverse effect on a financial institution's overall soundness.

LIST OF PARTIES

Petitioner is The Greene County Bank, an insured state nonmember bank. Respondent is the Federal Deposit Insurance Corporation.

Pursuant to Supreme Court Rule 29.1, Guaranty Bancshares, Incorporated is identified as the parent of The Greene County Bank. Neither Guaranty Bancshares, Incorporated nor The Greene County Bank has subsidiaries.

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PETITION FOR A WRIT OF CERTIORARI

Petitioner The Greene County Bank respectfully requests that a writ of certiorari issue to review the judgment of the United States Court of Appeals for the Eighth Circuit entered in this case.

OPINIONS BELOW

The opinion of the court of appeals is reported at 92 F.3d 633 (8th Cir. 1996), and is included in the Appendix at pp. 1a-7a. The decision of the Board of Directors of the Federal Deposit Insurance Corporation and the Administrative Law Judge's Recommended Decision are unreported and are included in the Appendix at pp. 103a-129a and 8a-102a, respectively.

JURISDICTION

The judgment of the court of appeals was entered on August 7, 1996. This Court has jurisdiction under 28 U.S.C. § 1254(1).

STATUTORY PROVISION INVOLVED

12 U.S.C. § 1818(b)(1) is included in the Appendix at pp. 130a-131a.

STATEMENT AND INTRODUCTION OF THE CASE

This case arises out of an administrative cease and desist proceeding by the Federal Deposit Insurance Corporation ("FDIC") against The Greene County Bank (the "Bank") of Strafford, Missouri. FDIC brought a Notice of Charges against the Bank pursuant to 12 U.S.C. § 1818(b)(1), asserting that the Bank had engaged in "unsafe and unsound" practices in connection with its management of interest rate risk and compliance with an earlier Memorandum of Understanding ("MOU") to which the Bank had agreed in settlement of a prior proceeding also involving FDIC allegations of excessive interest rate risk.[1] An Administrative Law Judge found that the Bank had not engaged in any unsafe and unsound practices that would support a cease and desist order, and that the Bank's high capital, consistent earnings, and overall soundness presented no abnormal risks. The Judge recommended to the FDIC that the proceeding be dismissed. App. 99a.

The Board of Directors of the FDIC, however, disagreed with the Administrative Law Judge and entered a cease and desist order, finding that the Bank had engaged in an unsafe and unsound practice by not complying with the MOU. App. 127a-128a. The Eighth Circuit affirmed, and held, contrary to other circuit court decisions, that an unsafe or unsound practice need not have a reasonably

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[1] Interest rate risk is the potential adverse impact on a bank's earnings by the mismatching of interest rates paid on liabilities (bank deposits) and interest rates earned on assets (bank loans).

direct effect on an institution's overall soundness. App. 6a-7a.

The Eighth Circuit's ruling perpetuates a conflict among the circuits and broadens the FDIC's authority by inviting regulatory interference when actual financial risk to an institution is nonexistent. If left to stand, not only will this ruling subject financial institutions to suffocating over regulation, but it will also result in conflict and confusion over this important financial institutions regulatory issue.

A. Factual Background

The Greene County Bank is a small bank of about fifteen employees with one central office and two branches, headquartered in Strafford, Missouri. The Bank is owned by a holding company of which Mr. Bernard H. Rullman, Jr. and his wife, Joann, are the principal shareholders. The Bank's Board of Directors is comprised of Mr. Rullman, Mrs. Rullman, their son, and two bank employees. Mr. Rullman acts as President and Chairman of the Board of Directors, and has led the Bank's highly successful operations for sixteen years. Although the Bank was strong and well capitalized, it became the subject of criticism by bank examiners, primarily in the area of interest rate risk. As a result, as permitted by 12 U.S.C. § 1818(b)(1), the FDIC filed a Notice of Charges against the Bank on July 26, 1993. The Notice charged the Bank with unsafe and unsound banking practices and noncompliance with the MOU. The Bank denied all the charges, and the matter was heard before an Administrative Law Judge on January 24-27, 1994, in Springfield, Missouri.

B. The Agency Decisions

The Administrative Law Judge issued a 108-page recommended decision on October 31, 1994, recommending that all charges against the Bank be dismissed and the FDIC's request for a cease and desist order be denied. App. 8a-102a. For each specific concern raised by the FDIC, the Administrative Law Judge found that the evidentiary record disproved FDIC's position. For example, the Judge found that the Bank's interest rate risk was well within regulatory boundaries, and upheld all aspects of the Bank's interest rate risk management, including its basic hedging program, its long futures positions, and its investment in an option contract. *Id.* at 20a-21a, 24a-42a, 45a. FDIC's charge that the Bank failed to comply with the MOU was refuted by the Administrative Law Judge's finding that the Bank's regular reports and other submissions fulfilled in all material respects the bank's obligations under the MOU. *Id.* at 30a.

Significantly, the Administrative Law Judge found that the Bank consistently maintained capital in excess of the regulatory minimums – a condition highly indicative of safe and sound banking practices. Clearly impressed with Mr. Rullman and his leadership capabilities, the Judge endorsed the Bank's management and found that the evidence established Mr. Rullman had "successfully managed [the Bank] into a fairly strong institution." *Id.* at 62a. The overall healthy condition of the Bank was repeatedly noted. *Id.* at 9a-10a, 41a, 54a, 56a-57a, 59a, 66a, 69a-71a, 82a.

The Administrative Law Judge's exhaustive review and analysis of the evidence culminated in a finding that

the Bank had not engaged in any unsafe or unsound practices. *Id.* at 97a-99a. Notably, the Administrative Law Judge recognized the legal standard recently adopted and applied by the Third Circuit, requiring a link between the alleged "unsafe and unsound" banking practices and the overall soundness of the institution in order to justify enforcement action under the statute. *Id.* at 53a (citing *Seidman v. Office of Thrift Supervision*, 37 F.3d 911 (3rd Cir. 1994)). The Judge, however, chose not to address the conflict concerning the legal standard due to the strong factual record establishing that FDIC's cease and desist order was improper even under a definition of "unsafe and unsound" that did not require a link to financial soundness. *Id.*

The FDIC Board issued a 27-page decision and order on August 1, 1995, entering a cease and desist order against the Bank. App. 103a-129a. The Board praised the Administrative Law Judge and claimed to agree with his factual findings, *Id.* at 104a, 107a n.3, 115a, but nonetheless was "troubled" by the "ultimate decision not to issue a cease and desist order." *Id.* at 104a. No attempt was made to discuss in detail the very specific factual findings and legal conclusions entered by the Administrative Law Judge. *Id.* at 118a n.16. Instead, the Board entered a "modest order" in direct conflict with the Administrative Law Judge.[2] The Board, without finding that the Bank's

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[2] FDIC's attempt to portray the cease and desist order entered in this case as a "mild" remedy, while consistent with the Board's description of it as "modest," ignores several important considerations. A cease and desist order may serve as a launching point for several more severe penalties. Additionally, FDIC uses the existence of such an order as a

practices had some reasonably direct effect on its overall soundness, held that the Bank had engaged in unsafe and unsound practices which could result in an abnormal risk of loss. *Id.* at 127a.

C. The Court of Appeals' Ruling

The Eighth Circuit affirmed the decision and order of the FDIC Board of Directors on August 1, 1996. App. 1a-7a. It held that the Bank failed to comply with the MOU and that this was an unsafe and unsound practice.[3] *Id.* at 5a. Although the court acknowledged the other circuit courts' legal standard under the statute for finding a banking practice "unsafe and unsound," it rejected that legal standard in favor of its own contrary formulation. The Eighth Circuit's non-standard gives the FDIC latitude to burden bank management with formal enforcement actions when financial risk is minor, contingent, and remote.

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factor in its ongoing regulatory supervision of the Bank and in its determination of deposit insurance premiums. Each of these matters magnifies the effect of the order on the Bank and the importance of the question presented here.

[3] The court of appeals' decision permits what essentially is record keeping and paperwork, a task having no direct effect on the Bank's overall financial soundness, to trigger regulatory intervention and to heighten the potential for harsher penalties. These kinds of regulatory oversight concerns should be dealt with in the regular examination process, rather than through litigation.

REASONS FOR GRANTING THE PETITION

The Eighth Circuit's holding confers excessive authority upon FDIC to disrupt effective banking policies and to manipulate successful bank management. No one quarrels that the federal government must have flexibility to ensure that banking institutions are sound. However, if the standard by which FDIC is allowed to intercede is not connected to an institution's financial soundness, the FDIC is bestowed with power to regulate at its whim, and in essence, to "fix" what is unbroken.

In these circumstances, it is easy to understand why a number of circuits, in direct conflict with the Eighth Circuit decision here, have interpreted the statutory standard "unsafe and unsound" to mean practices and conditions that have a reasonably direct effect on an institution's overall financial soundness. *See infra* pp. 10-13. This divergence of judicial opinion on an issue that is fundamental to the regulation of the banking industry warrants review by this Court. This case presents the perfect vehicle for resolving the conflict in the circuits and addressing the question of the proper interpretation of the "unsafe and unsound" statutory language.[4]

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[4] A ruling by this Court overturning the court of appeals' definition of "unsafe and unsound" would be dispositive in this case. No question remains as to the Bank's financial soundness and the failure of FDIC to demonstrate that the alleged unsafe and unsound practices had any impact on that soundness. The extensive administrative record establishes that the Bank has a strong history of successful operations, and under present management has never had a loss year. FDIC does not dispute that the net income of the Bank has been steady over time and continues to exceed that of peer institutions. Additionally, as a

Review by this Court is also appropriate due to the need for a uniform standard. The problem demonstrated by this case is magnified by the numerous and diverse circumstances in which the statutory "unsafe and unsound" issue arises. In addition to FDIC, the federal government's four other financial institutions regulatory agencies – the Office of Thrift Supervision, the Office of the Comptroller of the Currency, the Federal Reserve Board, and the National Credit Union Administration – all employ that same standard.[5] Additionally, the standard is implicated in a wide array of financial institutions regulatory actions including officer removal, appointment of conservators, imposition of administrative sanctions, and director and officer common law actions.[6]

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result of the Bank's investment strategy of placing a majority of it assets in government-backed securities with essentially zero credit risk, the Bank has routinely exceeded capital requirements and the capital levels of peer institutions. *See also supra* pp. 4-5.

[5] *See, e.g., First Nat'l Bank of Bellaire v. Comptroller of the Currency*, 697 F.2d 674 (5th Cir. 1983); *Van Dyke v. Board of Governors of the Fed. Reserve Sys.*, 876 F.2d 1377 (8th Cir. 1989); *Franklin Sav. Ass'n v. Director, Office of Thrift Supervision*, 934 F.2d 1127 (10th Cir. 1991); *Doolittle v. National Credit Union Admin.*, 992 F.2d 1531 (11th Cir. 1993).

[6] *See, e.g., Van Dyke v. Board of Governors of Fed. Reserve Sys.*, 876 F.2d 1377 (8th Cir. 1989) (review of the Board's order removing bank president from his position for his engagement in unsafe and unsound practices); *Franklin Sav. Ass'n v. Director, Office of Thrift Supervision*, 934 F.2d 1127 (10th Cir. 1991), *cert. denied*, 112 S.Ct. 1475 (1992) (savings and loan association accused of engaging in unsafe and unsound practices brought suit challenging decision to appoint conservator for the institution); *Seidman v. Office of Thrift Supervision*, 37 F.3d 911 (3rd Cir. 1994) (chairman of savings and loan association

Thus, the circuit conflict and the concerns about agency overreaching presented in this case will continually arise as all the regulatory agencies exercise their authority in various banking contexts. The level of regulatory scrutiny should not depend upon the jurisdiction in which an action is filed.

The question presented in this case is whether the court of appeals erred in concluding that Congress intended the statutory standard of "unsafe and unsound" to mean that practices and conditions need not have a reasonably direct and adverse effect on a financial institution's overall soundness. The Eighth Circuit, in affirming the FDIC Board's order, relied on its own prior decisions holding that an " 'unsafe or unsound practice' exists where the conduct is 'deemed contrary to accepted standards of banking operations which *might* result in abnormal risk or loss to a banking institution or shareholder.' " App. 6a (emphasis added) (quoting *First Nat'l Bank of Eden v. Department of the Treasury*, 568 F.2d 610, 611 n.2

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brought petition for review of order imposing administrative sanctions for unsafe and unsound practices); Heidi Mandanis Schooner, *Fiduciary Duties' Demanding Cousin: Bank Director Liability of Unsafe or Unsound Banking Practices*, 63 GEO. WASH. L. REV. 175 (1995) ("unsafe or unsound banking practices serve as a statutory trigger for every important formal enforcement proceeding available against banking directors"); *Resolution Trust Corp. v. Hess*, 820 F.Supp. 1359 (D. Utah 1993) (action brought against former savings and loan directors for negligence and breach of fiduciary duty in connection with various unsafe and unsound loan transactions). *See also*, 12 U.S.C. § 1818(e)(1); 12 U.S.C. § 1813(q)(1); 12 U.S.C. § 1464(d)(2)(A)(iii); 12 U.S.C. § 93; 12 U.S.C. § 1467a; 12 U.S.C. § 1782; 12 U.S.C. § 1786; 12 U.S.C. § 1842.

(8th Cir. 1978) and citing *Oberstar v. FDIC*, 987 F.2d 494, 502 (8th Cir. 1993)). The opinions relied upon by the Eighth Circuit also offered no statutory basis or legislative history for their holdings concerning the definition of unsafe and unsound practices. *Bank of Eden*, 568 F.2d at 611 n.2; *Oberstar*, 987 F.2d at 502.

In contrast to the Eighth Circuit's view of what defines an "unsafe and unsound" practice, the Fifth Circuit has held that "[t]he breadth of the 'unsafe or unsound practice' formula is restricted by its limitation to practices with a reasonably direct effect on an association's financial soundness." *Gulf Fed. Sav. & Loan Ass'n v. Federal Home Loan Bank Bd.*, 651 F.2d 259 (5th Cir. 1981), *cert. denied*, 458 U.S. 1121 (1982). The *Gulf Federal* opinion discusses the unsafe and unsound standard and reviews its legislative history:

> The "unsafe or unsound practice" provision was the subject of lively congressional concern at the time section 1464(d)(2)(A) was enacted. Several congressmen expressed the view that the "unsafe or unsound practice" formula was too broad and delegated unlimited authority to the Board. *See, e.g.*, 112 Cong. Rec. 25008 (1966) (remarks of Rep. Holifield). The Senate report on the bill noted that the committee had tried to balance the Board's need for flexibility in enforcement against the public's desire to be free of undue federal interference. *See* S. Rep. No. 1482, *supra*, at 3534-35. Representative Patman, the committee chairman and sponsor of the House bill, recognized these fears and admitted that the House committee had been concerned over possible agency abuse of the "unsafe or unsound" provision. 112 Cong. Rec.

24984 (1966) (remarks of Rep. Patman). He nevertheless assured his fellow legislators that "[w]e of the committee are of the opinion that these terms are sufficiently exact and do not involve an overly broad delegation of power to administrative agencies." *Id.*

The breadth of the "unsafe or unsound practice" formula is restricted by its limitation to practices with a reasonably direct effect on an association's financial soundness. As Representative Patman pointed out during the House debate,

> [o]f course, it should be clear to all that the cease-and-desist powers and management removal powers are aimed specifically at actions impairing the safety or soundness of our insured financial institutions. These new flexible tools relate strictly to the insurance risk and to assure [sic] the public sound banking facilities.

112 Cong. Rec. 24984. The authoritative definition of an unsafe or unsound practice, adopted in both Houses, was a memorandum submitted by John Horne, then chairman of the Bank Board. *See* 112 Cong. Rec. 24984 (1966) (remarks of Rep. Patman) (Horne memorandum authoritative in House); *id.* at 26474 (remarks of Sen. Robertson) (Horne memorandum included in record in Senate). Chairman Horne defined the provision in the following way:

> Generally speaking, an "unsafe or unsound practice" embraces any action, or lack of action, which is contrary to generally accepted standards of prudent operation, the possible consequences of which, if continued, would be abnormal risk or loss or damage to an institution, its shareholders,

> or the agencies administering the insurance funds.
>
> 112 Cong. Rec. 26474 (1966). Chairman Horne listed several practices that fell within his definition. The examples included such management defalcations as paying excessive dividends, disregarding a borrower's ability to repay, careless control of expenses, excessive advertising, and inadequate liquidity. *Id.*

651 F.2d at 263-64; *see also First Nat'l Bank of Bellaire v. Comptroller of the Currency*, 697 F.2d 674, 681 (5th Cir. 1983) (proceedings limited to practices with a reasonably direct effect on a bank's financial stability).

Influenced by the congressional comments, the *Gulf Federal* court rejected a cease and desist order that bore "only the most remote relationship to Gulf Federal's financial integrity and the government's insurance risk" and "could lead to a minor loss for Gulf Federal." *Id.* at 264. Summarizing its holding, the court stated: "We limit the 'unsafe or unsound practice' provision to an association's financial condition," *id.* at 265, and "the 'unsafe or unsound practice' provision . . . refers only to practices that threaten the financial integrity of the association," *id.* at 267. In this case, the Bank urges this Court to adopt the Fifth Circuit's legislatively supported and well-reasoned standard.

Subsequent decisions of the Ninth and Third Circuits have followed this "unsafe and unsound" statutory standard. In *Hoffman v. Federal Deposit Ins. Corp.*, 912 F.2d 1172, 1174 (9th Cir. 1990), the court reviewed a cease and desist order entered by FDIC against a bank president. The decision affirmed the issuance of the FDIC order by

finding that the president's actions, if continued, would result in an "abnormal risk of loss or damage to [the bank]," and that the actions had a "reasonably direct effect on [the bank's] financial soundness." *Id.* at 1174. In *Seidman v. Office of Thrift Supervision*, 37 F.3d 911 (3d Cir. 1994), the decision was entered on a petition for review of a cease and desist order entered by the Director of the Office of Thrift Supervision pursuant to 12 U.S.C. § 1818(b)(l). The Third Circuit held that "[t]he imprudent act must pose an abnormal risk to the financial stability of the banking institution" and "[c]ontingent, remote harms that could ultimately result in 'minor financial losses' to the institution are insufficient to pose the danger that warrants cease and desist proceedings." *Id.* at 929 (quoting *Gulf Fed.*, 651 F.2d at 264).

The intended statutory link between banking practices and financial soundness adopted by Congress and recognized by the Third, Fifth, and Ninth Circuits eliminates the fears of regulatory overreaching and provides the proper balance between protection of the public fisc and protection of financial institutions from arbitrary government action. *First Nat'l Bank of Bellaire*, 697 F.2d at 681 (objective is to balance the interests of the government against the interest of banks in receiving fair treatment; the government must not "become so obsessed with protecting the integrity of the national banking system that individual banks are arbitrarily treated unfairly").

Aside from the conflict in the circuits engendered by the Eighth Circuit's holding, the court's sweeping definition of unsafe and unsound practices dangerously allows for abuse of regulatory authority. The Eighth Circuit's

definition essentially destroys the standard altogether. Successful bank management obviously requires some degree of risk.[7] FDIC could legitimately claim that almost all banking practices "*might* result in abnormal risk or loss to a banking institution." App. 6a (emphasis added). As demonstrated by this case, the Eighth Circuit's unsafe and unsound formula allows FDIC to change a bank's procedures, and potentially change a bank's management structure, even though the bank is strong, well-capitalized, and initiating legitimate, successful investment strategies – results Congress feared and sought to avoid. *See supra* pp. 10-12.

The Eighth Circuit approach results in the absurd situation of FDIC having the power to "fix" what is unbroken. The Administrative Law Judge best summarized this view when he stated:

> [The FDIC examiner] expressed a large number of criticisms of the practices of [the Bank], concluding in each instance that the subject practice is unsafe and unsound, and could potentially have an abnormal risk or loss to the bank, to its shareholders, and to the Deposit Insurance Fund.
>
> It is recognized that the logical possibility exists that these criticisms are valid, and the bank could nevertheless be in good shape, but the question does persist of how a bank so riddled with unsafe and unsound practices could

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[7] *See* App. 72a (Administrative Law Judge recognized that a certain amount of interest rate risk is inherent and appropriate in commercial banking).

achieve good earnings, and increase its capital, during an economic recession.

App. 52a.

* * *

Regulatory authorities wield broad power over financial institutions. A cease and desist order affects a bank's policies and procedures, and can be used as an instrument to manipulate bank management. With the government's ongoing use of its financial institution regulatory powers, the issue presented in this case is certain to recur. Only this Court can resolve the problem presented by the Eighth Circuit's aberrational "unsafe and unsound" standard and thereby establish a uniform standard that will bring needed clarity to financial institutions regulation.

CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted,

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